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E.O. 12958: DECL: 01/23/2019
TAGS: ECON EFIN VE
SUBJECT: AS DICTATED BY CHAVEZ, CENTRAL BANK TRANSFERS 29 PERCENT OF RESERVES TO FONDEN

REF: A. 2008 CARACAS 1554
¶B. CARACAS 87

Classified By: Economic Counselor Darnall Steuart for reasons 1.4 (b) and (d).

¶1. (C) Summary: On January 21, Central Bank of Venezuela (BCV) reserves dropped by USD 12.5 billion dollars (29 percent of total reserves), apparently reflecting a transfer of USD 12.3 billion dollars to the National Development Fund (Fonden). This transfer is unprecedented for its size. While the BCV has moved "excess reserves" to Fonden every year since 2005, the current amount is almost twice the largest amount of any previous year. This transfer gives President Chavez greater discretion over the use of the hard currency, but it is inherently inflationary and will put greater pressure on the parallel exchange rate. Given Venezuela's precarious economic situation and with lower oil prices expected to persist through 2009, this transfer is a brazen move and signals President Chavez will continue to pursue unorthodox policies until he has no other alternative. End summary.

A Quick 12 Billion...

¶2. (U) President Chavez announced on January 22 that the BCV had transferred on January 21 excess reserves estimated at more than USD 12 billion to Fonden. BCV statistics published January 22 indicated a drop in reserves on January 21 from USD 42 billion to 29.5 billion, and an accompanying note explained that USD 12.3 billion was reclassified in the BCV's balance sheet from "reserves" to "other assets in hard currency." Given past practice and Chavez's remarks, this amount has been or will be transferred to Fonden, a quasifiscal development fund established in 2005.

¶3. (U) Transfers of this type began with a 2005 reform to the Central Bank law requiring the BCV and the National Assembly to establish an "adequate level of reserves" and authorizing the one time transfer of USD 6 billion from the BCV to the government. From 2005 through 2008, the BCV transferred "excess reserves" worth USD 18.5 billion to Fonden, which also received USD 27.4 billion from PDVSA in this time period. (Note: Many local analysts believe transfers from the BCV to Fonden subsequent to 2005 are without legal basis. End note.) In remarks in recent weeks, Chavez had indicated that another transfer from the BCV to Fonden on the order of USD 12 billion was forthcoming. The

January 21 transfer therefore came as no surprise. It is unprecedented in terms of its scope, however, as it is almost twice the previous highest transfer from the BCV to Fonden in a single year (USD 6.7 billion dollars in 2007).

...With Strings Attached

¶4. (SBU) Transfers of hard currency from the BCV to Fonden have several significant consequences. First, they give Chavez greater discretion over how the hard currency is used. Fonden's finances are not transparent (particularly compared to the BCV's), and its spending does not go through the normal budgetary process (ref A). However, these transfers are inherently inflationary, put pressure on the parallel exchange rate, and reduce the amount of reserves available to finance imports through normal channels. Forcing the BCV to give up dollars without receiving bolivars (Bs) in return is basically the equivalent of printing money. (Note: The BCV, when it received the dollars in the first place, would have put bolivars into the economy in return. Thus, when the transfer is concluded, the dollars have returned to the economy but the bolivars previously injected into the economy have not returned to the BCV. The net result is an increase in bolivars in the economy. End note.) The transfer puts pressure on the parallel exchange rate because traders know the BCV has fewer reserves to back the bolivars in circulation. With the January 21 drop in reserves, the ratio of liquidity (M2) to reserves (a measure often used by traders as a benchmark of expectations for the parallel exchange rate) increased from 4.5 to 6.5 Bs/USD.

¶5. (SBU) A strange twist on the January 21 transfer, in addition to its unprecedented size, is the jump in reserves registered in the last two days of 2008. On December 30 and 31, without any official explanation, BCV reserves rose from USD 38 to 43 billion. Local economic analysts generally believe this jump corresponded to sales of dollars to the BCV by PDVSA and Fonden, although they note the transaction remains obscure. If indeed Fonden sold dollars to the BCV in December (receiving bolivars in return), only to have the dollars transferred back to Fonden in January (without bolivars returning to the BCV), the two transactions represent, in the words of one economist, "an unlimited financing mechanism" with "disastrous" inflationary consequences if the mechanism continues being used.

Comment

¶6. (C) The transfer of almost 30 percent of the BCV's reserves to Fonden is a brazen move given the country's precarious economic situation (ref B) and low oil prices. It is now abundantly clear that the GBRV cannot maintain imports at 2008 levels during 2009 without reserves dropping to critical levels. The transfer signals President Chavez is unlikely to change Venezuela's economic course until he has no other alternative. End comment.
CAULFIELD